HOUSE BUDGET COMMITTEE

Democratic Caucus

The Honorable John M. Spratt Jr. ■ Ranking Democratic Member

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Greenspan Validates Several Key Democratic Budget Positions

Dear Democratic Colleague:

Last Thursday, Federal Reserve Chairman Alan Greenspan testified before the House Budget Committee. It came as no surprise to us that he did not reverse his past support for last year's Republican tax cuts. But on other topics Chairman Greenspan supported a number of important points about the budget that Democrats have consistently emphasized.

- ***Budget Has Deteriorated Dramatically*** (See Appendix 1)—Chairman Greenspan confirmed the dramatic reversal in the federal budget since last year. According to the latest baseline projections of the Congressional Budget Office (CBO), the $5.6 trillion ten-year surplus projected last year now stands at $0.3 trillion, which will mean that $2.0 trillion will be diverted from the Social Security Trust Fund surplus over the next decade. By contrast, Republicans have consistently rejected the view that our budget is in trouble.

- ***True Budget Picture Even Worse than Numbers Show*** (See Appendix 2)—Chairman Greenspan testified that the underlying budget picture is even worse than the projections indicate, because the government's accounting system does not reflect the future liabilities of Social Security and Medicare. Democrats have long argued that the fiscal challenges associated with the retirement of the baby boom generation make urgent our efforts to protect the Social Security surplus and pay down the national debt—goals undermined by oversized Republican tax cuts.

- ***Deficits Have Negative Effect on Economy*** (See Appendix 3)—Chairman Greenspan clearly stated his belief that deficits have an adverse impact on long-term interest rates, which in turn are crucial determinants of economic growth. Democrats have consistently argued—and Chairman Greenspan agreed—that the fiscal discipline of the 1990s was fundamental to that decade's economic growth. Oversized Republican tax cuts threaten to reverse this virtuous economic cycle.

- ***Republican Tax Cuts Are Largest Single Factor in Surplus Deterioration*** (See Appendix 4)—Chairman Greenspan confirmed that the single greatest component of the erosion of the budget surplus since last year has been the President's tax cuts. The Administration's own budget numbers refute Republican attempts to deny the leading role of tax cuts in the surplus deterioration.

- ***Triggers on Surplus-Reducing Policies Are Beneficial*** (See Appendix 5)—Chairman Greenspan repeated his support (ironically, expressed before the enactment of last year's oversized Republican tax cut) for a trigger mechanism that would "switch off" policies that reduced surpluses or increased deficits in the event that surplus projections proved overly optimistic. Democrats have repeatedly proposed such triggers as a way to protect the Social Security surplus, but Republicans have consistently rejected these proposals. In particular, Republicans have prevented Democrats from offering the Restore Fiscal Discipline and Safeguard Social Security Act (the Moore-Spratt-Davis-Moran bill) on the House floor, including objecting to a unanimous consent request that it be made in order.

- ***Expiring Budget Process Rules Need to Be Renewed; Future Tax Cuts Should Be Offset*** (See Appendix 6)—Chairman Greenspan emphasized the important role that current budget enforcement rules have played in reducing deficits. He called unequivocally for the extension of these budget enforcement mechanisms, which are scheduled to expire on September 30. Among other things, this would mean that future tax cuts would need to be offset by revenue increases or spending reductions.

- ***"Dynamic Scoring" of Tax Cuts Not Feasible*** (See Appendix 7)—Chairman Greenspan testified that dynamic scoring of policies cannot, as a practical matter, be done successfully for the foreseeable future because economists lack models of the economy that would provide accurate results. House Republicans have been working aggressively to get the Joint Taxation Committee and CBO to adopt dynamic scoring because it would mask the true cost of their huge tax cuts.

In sum, though Democrats do not agree with everything that Chairman Greenspan said at yesterday's hearing, his testimony did reinforce many of the main points that Democrats have made in recent debates about the budget. Please do not hesitate to call me or the Budget Committee Democratic staff with any questions.

Sincerely,

John M. Spratt, Jr.
Ranking Democratic Member

Appendix 1

Budget Has Deteriorated Dramatically

Greenspan: "A year ago, the Congressional Budget Office expected the unified budget to post large and mounting surpluses over the coming decade. As you know, CBO is currently forecasting that if today's policies remain in place, the unified budget will post deficits through fiscal year 2005. For the fiscal year just ending, CBO now projects a budget balance that is more than $300 billion below the level it had projected a year ago. To a degree, the return to budget deficits resulted from temporary factors, especially the falloff in revenues and the increase in outlays associated with the economy's downturn. But some of the factors accounting for the weaker budget outlook will have longer-lasting effects."

Appendix 2

True Budget Picture Even Worse than Numbers Show

Greenspan: "Besides the near-term budgetary shortfalls that we currently face, the aging of the population presents a daunting long-term fiscal challenge."

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Spratt: "...if we had accrual accounting, we would have a deficit, would we not, for as far as the eye sees, irrespective of these underlying numbers, because the accrual for Medicare and Social Security future liabilities alone would drive the bottom line down?"

Greenspan: "Yes, that is right, Congressman."

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Greenspan: "...the commitments we are making, especially now in the context of the fact that we have this major demographic shift, really require us to look deep, as deep into the future as we can. We are doing that implicitly by every passage of a bill that comes to the floor of this House. It is far better to at least focus on it. We may not know any more or learn any more by focusing on it, but it has to be an improvement over just making believe there is no problem."

Appendix 3

Deficits Have Negative Effect on Economy

Greenspan: "Mr. Chairman, it took many years for the markets to take seriously the efforts of the budget committees to construct mechanisms to hold spending and budget deficits in check. As they did, as they began to take it seriously, really realizing that in fact it was a very potentially productive effort, you could see markets adjust. Long-term interest rates did come down. You could see expectations of inflation fall. You could see a whole series of positive elements emerging in the financial markets, which had been for years beset by crowding out of American savings for the need to finance the unified budget deficit."

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Greenspan: "There is a large dispute within the economics profession of the impact of government debt and deficits on long-term interest rates. I am in the camp which believes there is a very close connection over the long run. To be sure, there are many other factors which affect long-term interest rates, but if you watch the way markets behave and indeed the economics of it very strongly suggest that long-term interest rates, both real and nominal, are affected in a significant manner by the long-term fiscal outlook, and when you change the long-term fiscal outlook or, more exactly, when the markets perceive a change in the long-term fiscal outlook, interest rates react immediately."

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Greenspan: ...all the evidence that we have is that, at the end of the day, very large Federal debt does have an impact on interest rates and interest rates affect a very large part of the capital structure of our economy which we are trying to make more efficient."

Appendix 4

Republican Tax Cuts Are Largest Single Factor in Surplus Deterioration

Moran: "The current CBO Director has had the intellectual integrity, though a Republican, to tell his own party what they needed to know instead of what they wanted to hear. In his latest report he shows that the single greatest component to the erosion of the $5.6 trillion budget surplus and this projection of deficits in excess of $200 billion a year is primarily attributable to the tax cuts."

Greenspan: "That is factually accurate."

Appendix 5

Triggers on Surplus-Reducing Policies Are Beneficial

Spratt: "...if the forecast didn't fulfill itself, if it didn't obtain and the budget went deeper in deficit and surpluses disappeared, we might want to trigger off those surplus-affecting policies. Do you still support some sort of mechanism like that as well as the other two you mentioned?"

Greenspan: "I do, Congressman, and the reason I do is that it has become evident over the years that the commitments that we make within the budget are increasingly longer term and have long lives to them."

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Greenspan: "And therefore, because it is so difficult to forecast, I think it is essential that we have triggering mechanisms of one form or other on both taxes and spending initiatives."

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Spratt: "But in addition to that, being honest, looking back, saying hey, what we expected has not happened, therefore we have to change the plans that we based upon those expectations?"

Greenspan: "Oh, absolutely."

Appendix 6

Expiring Budget Process Rules Need to Be Renewed; Future Tax Cuts Should Be Offset

Greenspan: "The statutory limits on discretionary spending and the so-called PAYGO rules requiring changes in mandatory spending and revenue policies to be budget-neutral, backed by a 60-vote point of order in the Senate, served as useful tools to control the deficits. In essence, the rules provided a means for advancing the broader good of sound fiscal policy over narrower interests."

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Greenspan: "...the commitment to fiscal responsibility that served us so well must now be re-established. The budget enforcement rules are set to expire on September 30. Failing to preserve them would be a grave mistake in my judgment. For without clear direction and constructive goals, the inbuilt political bias in favor of budget deficits likely will again become entrenched."

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Greenspan: "To summarize, then, now is not the time to abandon the discipline and structure that worked so well for so long. The framework enacted in the Budget Enforcement Act of 1990, and extended several times, must be preserved."

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McDermott: "Do you believe that from this point forward we ought to apply PAYGO rules to any tax bill, whether it is an extension or any new one?"

Greenspan: "My view is that the simplest thing to do is merely extend the existing statute. But if you find ways to improve upon it and make it far more effective, I think that would be most helpful."

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McDermott: "All new tax cuts PAYGO should apply to, in your opinion? I mean, you would encourage us to put that in process?"

Greenspan: "Well, yes, certainly. In other words, if you have PAYGO, it applies, and it applies to new tax cuts, it applies to new spending initiatives."

Appendix 7

"Dynamic Scoring" of Tax Cuts Not Feasible

McDermott: "Can we do dynamic scoring? I mean, do you believe in that concept?"

Greenspan: "Well, dynamic scoring is the ideal in endeavoring to evaluate any spending or tax program. The reason we tend not to do it and go to what we call static scoring is that it is very difficult to get general agreement on what the feedback effects of various different programs are, whereas there seems to be a general agreement on getting the gross impact of a program that is through static scoring, so that we have a general consensus. If we could find a way in which there was a general consensus as to how the economy fed back the impact of those various programs in secondary and tertiary ways, that would be an improvement on our techniques to determine the impact of various programs. We have not been able to do that."